

**Management Advisory Report:  
The Notice Review Program Should Be  
Improved to Prevent Erroneous Notices  
From Being Sent to Taxpayers**

**May 2001**

**Reference Number: 2001-40-078**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

May 1, 2001

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in cursive script that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Management Advisory Report - The Notice Review  
Program Should Be Improved to Prevent Erroneous Notices  
From Being Sent to Taxpayers

This report presents the results of our review of the IRS' process for reviewing potentially inaccurate notices before they were mailed to taxpayers. In summary, we found the Internal Revenue Service (IRS) could improve the Notice Review Program to reduce the risk that taxpayers receive erroneous notices and refunds. The following conditions increased the risk that taxpayers received erroneous notices and refunds:

- The IRS did not review all potentially erroneous notices.
- The Submission Processing Centers did not place priority on notices with the highest potential for error.
- National oversight of the Notice Review Program could be improved.

Because the IRS is in the process of moving the current Notice Review Program into its new business organization, we did not make recommendations for Program improvements and did not require a formal response. We asked that IRS management respond by April 23, 2001, if they elected to do so. As of April 24, 2001, management had not provided a response to this report.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Walter Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 936-4590.

**Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

**Table of Contents**

Executive Summary.....	Page i
Objective and Scope.....	Page 1
Background .....	Page 1
Results .....	Page 2
The Internal Revenue Service Did Not Review All Potentially Erroneous Notices.....	Page 2
The Submission Processing Centers Did Not Place Priority on Reviewing Notices With the Highest Potential for Error.....	Page 4
National Oversight of the Notice Review Program Could Be Improved.....	Page 4
Conclusion.....	Page 5
Appendix I – Detailed Objective, Scope, and Methodology .....	Page 6
Appendix II – Major Contributors to This Report.....	Page 9
Appendix III – Report Distribution List.....	Page 10
Appendix IV – Volume of Notices Reviewed—Week of April 16, 2000.....	Page 11

# **Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

## **Executive Summary**

The Internal Revenue Service (IRS) has identified improving customer service as one of its major initiatives. As a result, it placed a priority on improving the quality of notices issued to taxpayers. From January through September 2000, the IRS mailed approximately 12.4 million notices to individual taxpayers. These notices were designed to inform them of taxes, interest, and penalties due; errors they made on their tax returns; or adjustments to their tax accounts.

The IRS established a process to identify and analyze potentially incorrect notices. This review was the last point in the IRS' process where notices could be corrected before they were mailed to taxpayers. From January through September 2000, the IRS identified 4.1 million potentially erroneous notices for review.

The overall objective of this audit was to evaluate the IRS' process for reviewing potentially inaccurate notices before they were mailed to taxpayers. We focused our review on notices that were prepared for individual taxpayers from January 1, 2000, through September 30, 2000, as a result of processing their tax returns.

## **Results**

The IRS could have done more to ensure taxpayers did not receive erroneous refunds and notices. The IRS did not review all potentially erroneous notices or prioritize its work so that notices with the highest potential for error were reviewed first. In our opinion, limited national oversight of the program contributed to these conditions.

### **The Internal Revenue Service Did Not Review All Potentially Erroneous Notices**

From January through September 2000, the IRS reported that it did not review 539,852 (13 percent) of the 4.1 million notices identified as having a high potential for error.<sup>1</sup> If the error rate for these notices is consistent with that found on notices that were reviewed, the IRS may have incorrectly notified 80,702 taxpayers about an additional tax liability, an error on their return, or an adjustment to their account. Wage and Investment taxpayers<sup>2</sup> usually contact the IRS only once a year, when they file their tax returns.

---

<sup>1</sup> We did not validate the accuracy of data provided by the IRS.

<sup>2</sup> Individual taxpayers whose income generally consists of Wage and Tax Statement (Form W-2) wages and investment income.

## **Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

However, taxpayers who receive an incorrect notice will, most likely, be forced to make additional IRS contacts.

### **The Submission Processing Centers Did Not Place Priority on Reviewing Notices With the Highest Potential for Error**

IRS procedures did not ensure that notices with the highest potential for error were worked first. From January through September 2000, the IRS reviewed approximately 1.5 million notices with error rates of 10 percent or less, while it did not review approximately 77,000 notices with anticipated error rates of 30 percent or higher. Not establishing a priority to review notices with the highest potential for error increased the risk that taxpayers received erroneous notices and refunds.

### **National Oversight of the Notice Review Program Could Be Improved**

Prior to October 1, 2000, responsibility for the oversight of the Notice Review Program was assigned to two different IRS operating functions. We identified issues that indicated the national oversight of the Program could have been more effective. For example, the data compiled to monitor and evaluate the Program were not reviewed.

## Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers

---

### Objective and Scope

*The objective was to evaluate the IRS' process for reviewing potentially inaccurate notices.*

The objective of this review was to evaluate the Internal Revenue Service's (IRS) process for reviewing potentially inaccurate notices before they were mailed to taxpayers. We focused our review on notices that the IRS prepared for individual taxpayers from January 1, 2000, through September 30, 2000, as a result of processing their tax returns.

We performed our work in the National Headquarters and the Atlanta, Austin, and Kansas City Submission Processing Centers. Our review was conducted from October through November 2000 and was performed in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*.

The Treasury Inspector General for Tax Administration is planning additional audit coverage of the Notice Review Program during Fiscal Year 2001. This review will focus on the methods the IRS uses to identify and select potentially erroneous individual notices for review.

Details of our objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

### Background

*The IRS has identified improving customer service as one of its major initiatives.*

The IRS has identified improving customer service as one of its major initiatives. As a result, it placed a priority on improving notices issued to taxpayers. From January through September 2000, the IRS mailed approximately 12.4 million notices to individuals. These notices were designed to inform them of taxes, interest, and penalties due; errors they made on their tax returns; or adjustments to their tax accounts.

The IRS developed a computer program to identify potentially incorrect notices. Employees in the review

## Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers

---

function had 1 week or less to analyze these notices before they were sent to taxpayers. The review was also designed to identify and correct incorrect tax refunds. This review was the last point in the IRS' process where notices could be corrected before they were mailed to taxpayers. From January through September 2000, the IRS identified 4.1 million potentially erroneous notices for review.

### Results

The IRS could have done more to ensure taxpayers did not receive erroneous refunds and notices. It did not review all potentially erroneous notices or ensure that notices with the highest potential for error were reviewed first. In our opinion, limited national oversight of the Program contributed to these conditions.

---

### The Internal Revenue Service Did Not Review All Potentially Erroneous Notices

---

*From January through September 2000, the IRS reported that it did not review 13 percent of the 4.1 million notices identified as having a potential for error.*

From January through September 2000, the IRS reported that it did not review 539,852 (13 percent) of the 4.1 million notices identified as having a high potential for error.<sup>1</sup> If the error rate for these notices is consistent with that found on notices that were reviewed, the IRS may have incorrectly notified 80,702 individual taxpayers about an additional tax liability, an error on their return, or an adjustment to their account.

Wage and Investment taxpayers<sup>2</sup> usually contact the IRS only once a year, when they file their tax returns. However, taxpayers who receive an incorrect notice will, most likely, be forced to make additional IRS contacts.

---

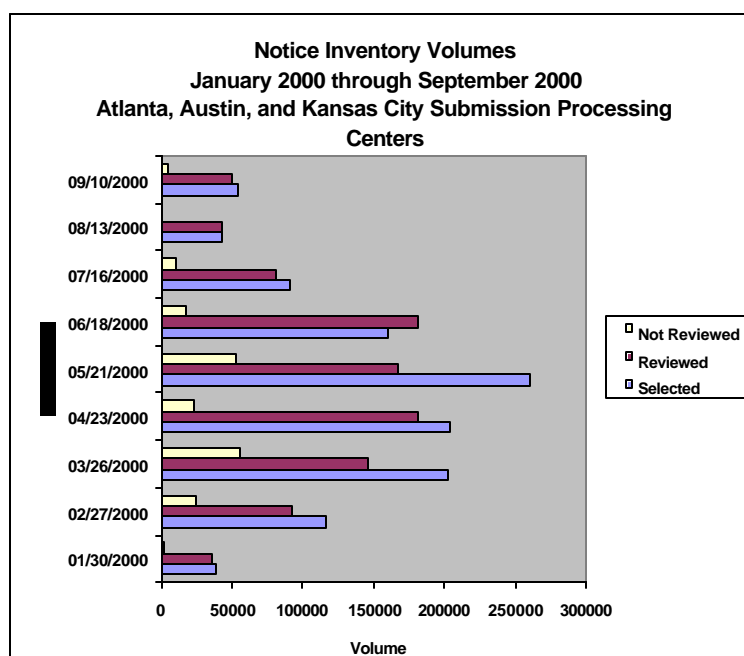
<sup>1</sup> We did not validate the accuracy of the data provided by the IRS.

<sup>2</sup> Individual taxpayers whose income generally consists of Wage and Tax Statement (Form W-2) wages and investment income.

## Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers

*Inventory for review in 3 processing centers reached a high of 260,295 notices during May, and 20 percent of those notices were not reviewed.*

The chart below shows the inventory volumes from January through September 2000 for three IRS processing centers. The largest inventories of notices identified for review occurred during March, April, May, and June 2000. This was the same time period that most individual taxpayers' 1999 tax returns were expected to be filed with the IRS. Inventory for review in the 3 processing centers reached its highest point of 260,295 notices during May. Of these notices, 53,036 (20 percent) were not reviewed.



Source: IRS Notice Disposition Reports for January 2000 through September 2000. We did not validate the accuracy of data provided by the IRS.

IRS guidelines required that all of the notices selected for review be reviewed. While we did not do a staffing analysis, we were advised by IRS executives that they did not have enough staff to work the entire inventory of potentially erroneous notices. Not reviewing the entire weekly notice inventory increased the probability that erroneous notices and refunds were mailed to taxpayers.



## Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers

---

### The Submission Processing Centers Did Not Place Priority on Reviewing Notices With the Highest Potential for Error

---

*The IRS did not prioritize the notice inventory to ensure that notices with the highest potential for error were analyzed first.*

The IRS did not prioritize the notice inventory to ensure that notices with the highest potential for error were analyzed first.<sup>3</sup> IRS procedures required that notices involving a refund be worked before those associated with a balance due. Guidelines indicated that when less than 100 percent of the refund notices could be reviewed, refund notices with the highest anticipated error rate should have been worked first. However, no such priority was established for notices that did not involve a refund.

*The IRS reviewed approximately 1.5 million notices with error rates of 10 percent or less, while it did not review approximately 77,000 notices with anticipated error rates of 30 percent or higher.*

From January through September 2000, the IRS reviewed approximately 1.5 million notices with error rates of 10 percent or less, while it did not review approximately 77,000 notices with anticipated error rates of 30 percent or higher. (Appendix IV shows the volume of notices reviewed and their corresponding error rates for the week of April 16, 2000.)

Not establishing a priority to review notices with the highest potential for error increased the risk that taxpayers received erroneous notices and refunds.

### National Oversight of the Notice Review Program Could Be Improved

---

We observed the following conditions that indicated the national oversight of the Program could have been more effective:

- The data compiled to monitor and evaluate the Notice Review Program were not reviewed. Instead, an employee who was not responsible for reviewing this Program maintained the data.

---

<sup>3</sup> We did not validate the accuracy of the data provided by the IRS.

## Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers

---

*Prior to the IRS' reorganization, oversight of the Notice Review Program was divided between two IRS operating functions.*

- The expectation for the processing centers to work all identified notices within the established time frame had not been re-evaluated to assess its viability.

We did not analyze these conditions to determine why they occurred. However, prior to the IRS' reorganization (October 1, 2000), oversight of the Notice Review Program was assigned to two different IRS operating functions. This could have contributed to these conditions.

### Conclusion

It is likely the IRS' Notice Review Program did not prevent some taxpayers from receiving incorrect notices and refunds. The IRS' current reorganization presents an opportunity for it to redesign this Program so that it meets the objective of ensuring the accuracy of taxpayer notices.

## **Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

### **Appendix I**

#### **Detailed Objective, Scope, and Methodology**

This review was part of the Treasury Inspector General for Tax Administration's discretionary audit coverage. The overall objective of the review was to evaluate the Internal Revenue Service's (IRS) process for reviewing potentially inaccurate notices before they were mailed to taxpayers. We focused our review on notices that were prepared for individual taxpayers from January 1, 2000, through September 30, 2000, as a result of the processing of their tax returns.

To determine whether the IRS reviewed all potentially erroneous notices before they were mailed to taxpayers, we performed the following audit work:

- I. Determined if emphasis was placed on the case selection hierarchy when the inventory was worked in the submission processing centers.
  - A. Analyzed the Notice Disposition Reports nationwide between April 17, 2000, and May 12, 2000, to determine if the processing centers placed a priority on reviewing the notices selected for review with specific selection criteria.
  - B. Interviewed managers and employees responsible for reviewing notices in the Atlanta, Austin, and Kansas City Submission Processing Centers to determine if there was a process to ensure that the inventory was worked based on the priority of selection keys.
  - C. Reviewed a written description of the notice review computer program and interviewed the notice review computer programmer to determine if there was a method for the processing centers to ensure they were reviewing the inventory in a priority order.
  - D. Compared the written explanation of the notice selection criteria to a notice review sign-out sheet for the week of October 20, 2000, to determine if the batch sheets used by the processing centers were printed to facilitate the prioritization of work by selection criteria.
  - E. Requested copies of written guidance from the National Headquarters to the processing centers indicating the priority of the notice review inventory.
  - F. Reviewed written IRS guidance documents to identify procedures involving the prioritization of the notice review inventory.

## **Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

- II. Determined the disposition of notices that were selected, but not reviewed, by the IRS.
  - A. Requested a copy of written guidance provided by the National Headquarters to the processing centers indicating procedures for handling notices that are selected for review but not reviewed.
  - B. Interviewed managers and employees responsible for reviewing notices in the Atlanta, Austin, and Kansas City Submission Processing Centers to determine if notices that were selected but not reviewed were:
    - 1. Held for future review.
    - 2. Mailed as is.
    - 3. Held using the “Label” disposition code so they would be brought back for review the following week. If so, we:
      - a) Determined the criteria for electing to use the “Label” disposition code to hold a notice.
      - b) Identified the process for notices that were closed using the “Label” disposition code.
      - c) Determined if notices that were closed using the “Label” disposition code were appropriately reflected in the Notice Disposition Report for January 1, 2000, through September 30, 2000.
  - C. Obtained national notice disposition data from the IRS and compared the number of notices selected for review nationwide from January 1, 2000, through September 30, 2000, to the number of notices actually reviewed during the same period. We did not validate the notice disposition data provided by the IRS.
    - 1. Analyzed the notices selected but not reviewed to determine if notices with higher potential error rates were not reviewed while notices with lower potential error rates were reviewed.
      - a) Identified 12.4 million selectable<sup>1</sup> notices for the period January 1, 2000, through September 30, 2000, by reviewing the IRS Individual Masterfile Notice Volume Reports for Fiscal Year 2000.

---

<sup>1</sup> Selectable notices are those that met the criteria set by the IRS as being potentially erroneous. Not all selectable notices are identified for review.

**Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

- (1) Analyzed the national notice disposition data to determine the number of notices reviewed that were identified as inaccurate notices.
- (2) Analyzed the national notice disposition data for the notices selected but not reviewed and stratified by error rate to determine the number and/or type of potentially erroneous notices that were sent to taxpayers.

**Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

**Appendix II**

**Major Contributors to This Report**

Walter E. Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs)

M. Susan Boehmer, Director

Deann L. Baiza, Audit Manager

Linda L. Bryant, Senior Auditor

Kathleen A. Hughes, Auditor

Sharla Robinson, Auditor

Bonnie G. Shanks, Auditor

**Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

**Appendix III**

**Report Distribution List**

Commissioner N:C  
Director, Customer Account Services W:CAS  
Director, Submission Processing W:CAS:SP  
Director, Legislative Affairs CL:LA  
Chief Counsel CC  
National Taxpayer Advocate TA  
Office of Management Controls N:CFO:F:M  
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O  
Audit Liaisons:  
    Commissioner, Wage and Investment Division W  
    Director, Customer Account Services W:CAS  
    Director, Submission Processing W:CAS:SP

## Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers

---

### Appendix IV

#### Volume of Notices Reviewed - Week of April 16, 2000

This Appendix provides a summary of the volume of notices reviewed and the associated error rate by notice selection category for the week of April 16, 2000. The Internal Revenue Service (IRS) uses a computer program to identify potentially erroneous notices for review. These notices are selected based on pre-established selection criteria. Each selection criterion uses a composite of more finite conditions called selection keys to identify and select notices for review.<sup>1</sup>

**Notice Selection Category A:** Selects notices identified during local processing for manual editing, such as notices requiring an uncommon explanation or notices requiring more explanations than the system was designed to use. Also, in limited situations, selects notices found to have national program design errors.

Number of Notices Selected:	2,384
Number of Notices Reviewed:	2,325
Number of Notices Not Reviewed:	59
Error Rate of Notices Reviewed:	92%

**Notice Selection Category B:** Enables submission processing centers to select specific notices identified by the taxpayer account number or document locator number during local processing for deletion or to select notices with specific situations for additional review, such as by balance due amount, type of return, penalty code, or adjustment reason code.

Number of Notices Selected:	389
Number of Notices Reviewed:	385
Number of Notices Not Reviewed:	4
Error Rate of Notices Reviewed:	31%

---

<sup>1</sup> The relationship between the notice selection categories and the selection keys was determined using Program Requirements Package 460 Section 106. We used data provided by the IRS for the week of April 16, 2000, to determine the volume and error rate by selection key.



## **Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

**Notice Selection Category B/J:** The Treasury Inspector General for Tax Administration cannot determine whether these notices were selected in Category B or J because the IRS did not include the Category in the Notice Disposition Report data, and some keys can be selected under either category.

Number of Notices Selected:	2,818
Number of Notices Reviewed:	2,816
Number of Notices Not Reviewed:	2
Error Rate of Notices Reviewed:	78%

**Notice Selection Category C:** Selects notices with situations where the computer has identified issues requiring additional review. Situations include large refund or balance due amounts or a bill and refund issued at the same time from different returns for the same taxpayer.

Number of Notices Selected:	1,001
Number of Notices Reviewed:	923
Number of Notices Not Reviewed:	78
Error Rate of Notices Reviewed:	28%

**Notice Selection Category D:** Selects notices involving situations where the IRS payment records differ from the taxpayer's records and the computer has identified new information that may eliminate the need for the notice.

Number of Notices Selected:	44,872
Number of Notices Reviewed:	41,505
Number of Notices Not Reviewed:	3,367
Error Rate of Notices Reviewed:	9%

## **Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

**Notice Selection Category E:** Selects additional notices in which the computer has identified new information that may eliminate the need for the notice.

Number of Notices Selected:	8,609
Number of Notices Reviewed:	6,879
Number of Notices Not Reviewed:	1,730
Error Rate of Notices Reviewed:	41%

**Notice Selection Category F:** Enables each submission processing center to identify additional notices by type of taxpayer error. Centers can adjust the volume of each type depending on the available resources and quality of the work performed at the center.

Number of Notices Selected:	107,443
Number of Notices Reviewed:	97,899
Number of Notices Not Reviewed:	9,544
Error Rate of Notices Reviewed:	15%

**Notice Selection Category G:** Selects refund or balance due notices resulting from taxpayer requests after the taxpayer has filed his/her return where the computer has identified issues requiring additional review.

Number of Notices Selected:	2
Number of Notices Reviewed:	1
Number of Notices Not Reviewed:	1
Error Rate of Notices Reviewed:	0%

**Notice Selection Category H:** Selects refund or balance due notices in which the computer has determined the accounts have similar situations that caused errors on past notices.

Number of Notices Selected:	3,701
Number of Notices Reviewed:	3,394
Number of Notices Not Reviewed:	307
Error Rate of Notices Reviewed:	20%

## **Management Advisory Report: The Notice Review Program Should Be Improved to Prevent Erroneous Notices From Being Sent to Taxpayers**

---

**Notice Selection Category I:** Selects refunds in which the computer has found duplicate credit transactions or other indicators that the refund may be incorrect.

Number of Notices Selected: 6,376

Number of Notices Reviewed: 6,326

Number of Notices Not Reviewed: 50

Error Rate of Notices Reviewed: 1%

**Notice Selection Category J:** Enables each submission processing center to identify additional notices for review by type of return or type of notice. Centers can adjust the volume of each type depending on the available resources and quality of the work performed at the center.

Number of Notices Selected: 6,718

Number of Notices Reviewed: 6,476

Number of Notices Not Reviewed: 242

Error Rate of Notices Reviewed: 39%

**Notice Selection Category K:** Selects situations in which a taxpayer has not filed an individual tax return but has reported employment tax information for an employee who worked in the taxpayer's home.

Number of Notices Selected: 95

Number of Notices Reviewed: 54

Number of Notices Not Reviewed: 41

Error Rate of Notices Reviewed: 11%

**Associated Notices:** Notices that did not meet selection criterion but may be affected by the review of another notice that was selected for the same taxpayer.

Number of Associated Notices Selected: 7,952

Number of Associated Notices Reviewed: 7,418

Number of Associated Notices Not Reviewed: 534

Error Rate of Associated Notices Reviewed: 11%